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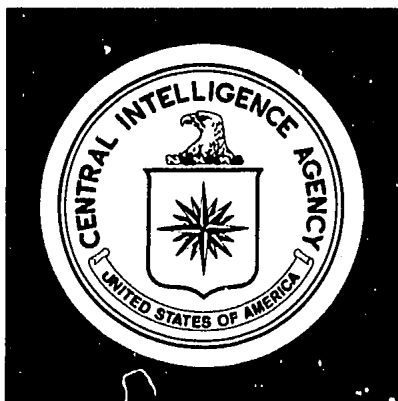
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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

The Economic Situation in South Vietnam

USAID review completed

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ER IM 72-166
November 1972

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
November 1972

INTELLIGENCE MEMORANDUM

THE ECONOMIC SITUATION IN SOUTH VIETNAM

Summary

1. With the enactment of new real estate, income, and motor vehicle tax laws in January, the government will be making a major attempt to increase domestic revenues and spread the tax burden more evenly among the population. Full implementation -- and thus maximum revenue yield -- will not, however, come before 1974.

2. The Asian Development Bank (ADB) recently granted its third and largest loan to South Vietnam and has indicated its desire to play a major role in the postwar reconstruction and development of the entire Indochina area.

3. Preliminary reconstruction plans from 13 provinces have been approved and funded by the central government so that essential government services such as schools, hospitals, and utilities can be restored in areas where security has been reestablished.

4. After increasing steadily for several weeks, the Saigon cost-of-living index has declined 3% since the end of October. Improved highway security has allowed the resumption of normal deliveries of perishable foodstuffs into the city, and prices of these items have fallen sharply.

5. Charts on foreign exchange reserves, money supply and prices, gold and currency prices, and the government budget (Figures 1-5) follow the text.

Note: This memorandum was prepared by the Office of Economic Research.

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Discussion

New Tax Measures

6. Revised property taxes recently decreed by President Thieu -- as well as decrees soon to be announced on income and motor vehicle taxes -- will provide some modest support for the government's stabilization efforts, but effects of the new measures on the economy are not likely to be felt for at least another year. Some of the provisions of the new tax laws will be introduced in stages beginning in January 1973, and the maximum revenue yield is not possible before 1974. Nonetheless, the new measures reflect a serious government effort to increase revenues from domestic sources and to spread the tax burden more evenly throughout the population.

7. The new property tax law is aimed at increasing revenues from agricultural lands -- long neglected as a primary tax base -- and involves a major restructuring of tax rates on cultivated land as well as on urban land and buildings. In addition to significant across-the-board increases in rates on real property, the new law contains stringent enforcement provisions, including seizure and sale of property, and calls for the organization of training programs for some 10,000 local officials who will administer the new system. Tax rates ranging from 3% to 6% on rural property are to be based on the value of production yields of the land; urban property will be taxed at rates of 0.5% to 1.5% on the market value of land and buildings. Yields from the new rate structure are expected to be 7.6 billion piasters during 1973, a sixfold increase over estimated revenues in 1972, and upon complete implementation during 1974 should be on the order of 12 billion piasters to 13 billion piasters per year. Because the property tax is collected and retained by local governments, the expected yield in revenues should help to reduce high levels of central government expenditures for provincial and local government programs.

8. A yet-to-be-enacted income tax law is designed primarily to encourage compliance with the existing system through stepped-up enforcement measures with effective penalties and simplification of tax forms and collection procedures. A single personal income tax schedule on all types of income will replace three separate schedules with varying rates. This new structure will be progressive, with rates ranging from 10% to 60%. In addition, the corporation income tax is to be increased from a single rate of 24% to a new rate of 48%. Although income taxes have been relatively insignificant sources of revenue in the past (only 12% of total domestic revenues in 1971), the new law should provide a more efficient mechanism to extract revenues from a potentially vast tax base through

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more universal application, particularly to high income earners in the business community. While no estimates of the expected increase in the yield from income taxation are available, it does not seem likely that revenues from this source will increase dramatically in the near future because of continuing pervasive tax avoidance and the difficulties inherent in developing an efficient tax-collecting bureaucracy.

9. The proposed tax on motor vehicles, slated for enactment in January-February of next year, is expected to yield 1.6 billion piasters in revenues during 1973, compared with a yield of only 0.3 billion piasters during 1972. This increase is to be the result of drastic rate changes, which in some instances (new cars) are to be increased as much as ninefold. The added revenues from this source appear to be relatively certain because the administrative apparatus for vehicle registration is already established and avoidance of the tax would be difficult.

10. The new tax measures reflect the need to increase domestic revenues to help cover an increasing share of growing government spending. It appears unlikely that the new taxes will have any impact on inflationary pressures in the near future. The yields of the new taxes, even under optimum compliance and administration conditions, are relatively small compared with the anticipated increases in government expenditures for refugee relief, reconstruction, and other offensive-related items. Deficit spending -- the major source of inflationary pressure -- will no doubt continue to grow at a rate higher than that for the gains in domestic revenues.

New ADB Loan

11. The Asian Development Bank (ADB) recently decided to make its third and largest loan to South Vietnam, thereby strengthening prospects for further assistance from the bank. On 14 November the ADB's board of directors approved a US \$6.3 million loan for the construction of electric power transmission and distribution facilities in Saigon to be completed by the end of 1975.⁽¹⁾ The added facilities will enable the Vietnam Power Co. to serve an additional 200,000 people in the metropolitan area, thereby nearly doubling its present customers.

1. The Japanese government also recently informed South Vietnam that it is willing to loan \$3.5 million for the construction of power transmission lines to connect the Da Nhim hydroelectric plant to the towns of Da Lat, Phan Rang, and Cam Ranh. Previous Japanese loans -- all for power and telephone facilities -- totaled \$4.5 million in 1970 and \$21 million in 1971.

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12. All the ADB loans to South Vietnam are financed from the bank's special funds, earmarked to provide for softer repayment terms than ordinary ADB loans. The power project loan, for example, is to be repaid in 25 years (including a seven-year grace period) with interest at 2.5% per year. The bank's first loan commitment - \$2.5 million - came in December 1970 and was earmarked for fisheries development, including mechanization of vessels and construction of cold storage plants. In December 1971 a second loan of \$2.5 million was made to finance the renovation of irrigation facilities near Qui Nhon in Binh Dinh Province. In addition, the ADB has made several technical assistance grants to South Vietnam, providing advisory services in the agricultural and banking sectors.

13. On the basis of the strong support of the board of directors for the power project loan, US officials associated with the ADB are optimistic that the bank will expand its lending to South Vietnam. Assuming the money is available, any additional loans are also expected to be made on very favorable terms. During the next few years, the ADB is likely to expand its involvement in other parts of Indochina as well. The bank already has indicated its desire to play a major role in the postwar reconstruction and development of the entire area.

Reconstruction Under Way

14. The Vietnamese government has initiated a province reconstruction program giving first priority to the restoration of local government services such as schools, utilities, and medical facilities. By the end of October, reconstruction plans had been approved by the central government for all or part of 13 provinces where security was re-established. Provinces and districts hardest hit by the fighting, however, such as those in Military Region I, are not included among the 13. At this stage the plans submitted by the provinces cover only immediate recovery needs, leaving aside most major reconstruction efforts, which in some areas could require several years.

15. The major financial and technical assistance for these initial reconstruction projects is coming from the various government ministries that have been ordered to set aside funds for this purpose from their 1972 and 1973 budgets. Reconstruction funds allotted thus far amount to about \$1 million, of which the largest share in most provinces is earmarked for construction of temporary school classrooms. Some funds have been designated for temporary repairs to bridges, but the bulk of this type of reconstruction will come later and be considerably more costly. Work already is under way in some provinces; and in Phuoc Tuy, the first province to have its plan approved, all projects are expected to be completed in early December. The speed with which essential services are being

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re-established (even if only on a temporary basis) is a substantial improvement from what might have been expected based on past South Vietnamese performance.

Market Developments

16. Following a 7% rise during October, retail prices in Saigon have declined 3% since early November.⁽²⁾ Improved security on the roads into the city since the end of October has permitted the resumption of normal deliveries of perishable foodstuffs, and prices of items such as vegetables and fish have dropped sharply. The overall price level has not dropped to the same extent, however, because of higher prices for some non-food items, especially cigarettes. Indeed, the price of cigarettes has risen more than 20% since the end of October, reflecting the shift of tobacco imports to a higher exchange rate.

17. The talk of a cease-fire apparently has had little effect on consumer behavior. Demand has not revived significantly, and the business recession in Saigon continues into its seventh month. Hoarding of rice, reported shortly after the news of the cease-fire broke at the end of October, was minimal and short-lived.

18. Political developments evidently have had a greater effect on the currency black market, as the price of dollars rose sharply at the end of October. Following the latest official devaluation of the piaster from 435:1 to 445:1 on 30 October, the black market rate fell back to the new legal rate, but then rose to 454 piasters per dollar in the week of 20 November. The price of gold also rose sharply at the end of October but has since remained stable at 27,400 piasters per troy ounce, or about \$62 converted at 445:1.

2. As of 20 November, prices were up 22% for the year.

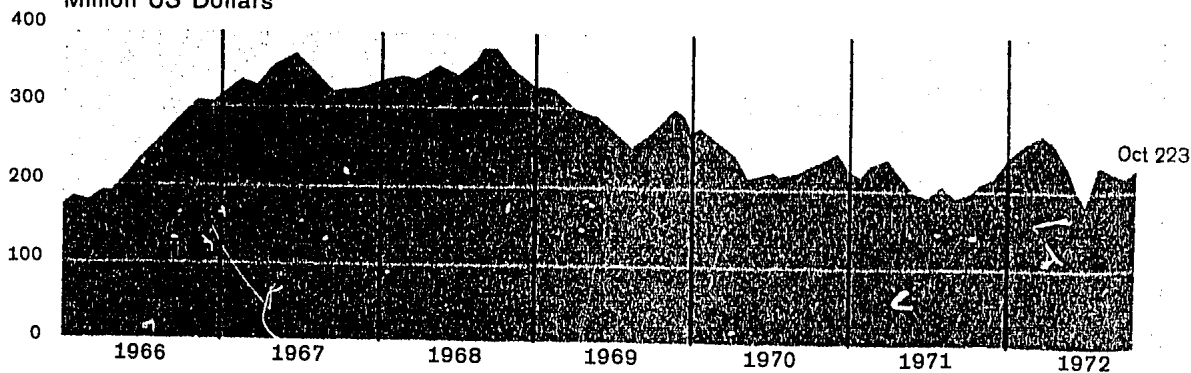
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SOUTH VIETNAM

Figure 1

Foreign Exchange Reserves*

Million US Dollars



*Excluding holdings of commercial banks

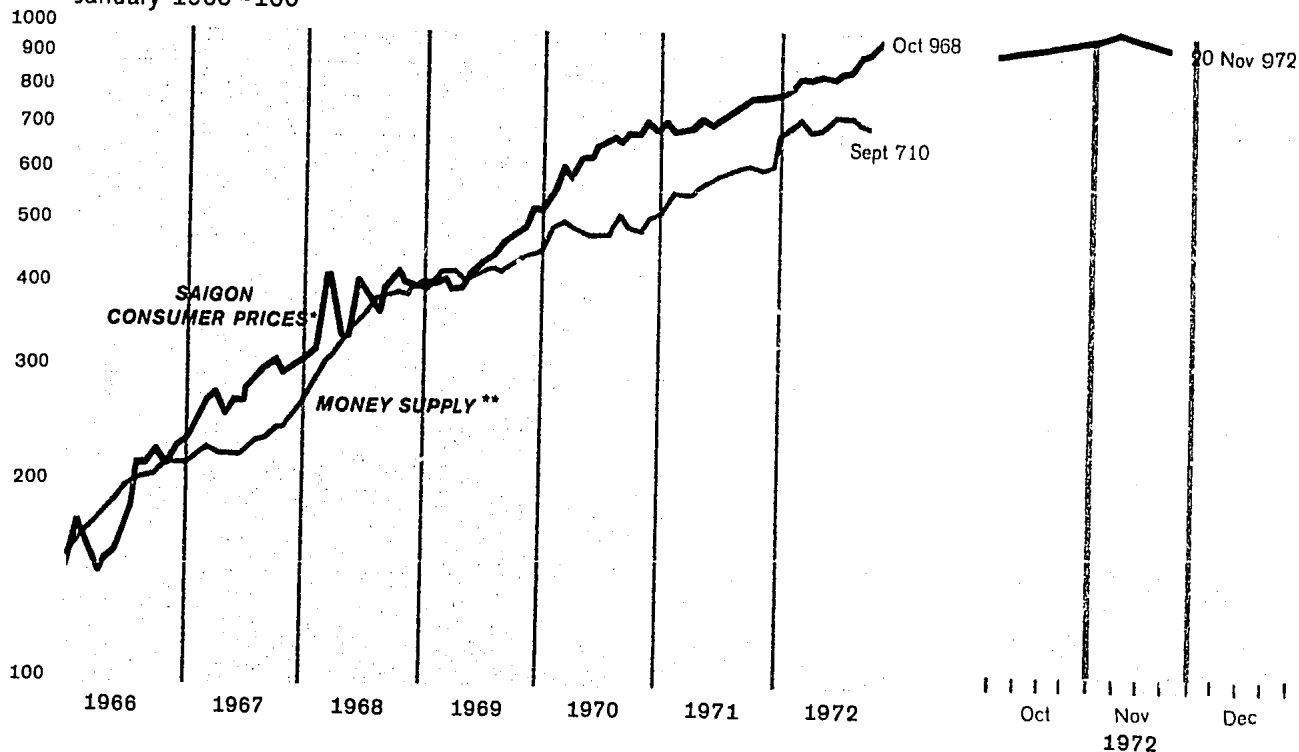
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Figure 2

Indexes of Money Supply and Saigon Consumer Prices

January 1965=100



*USAID monthly average retail price index for Saigon

**Data are for end of month

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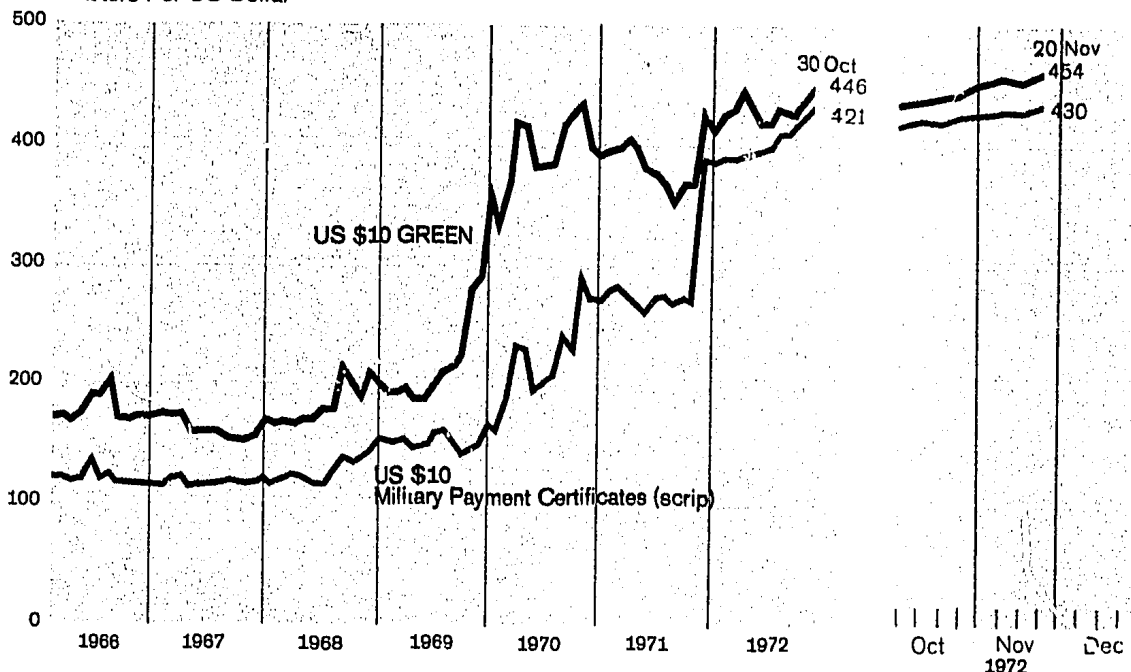
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SAIGON

Figure 3

Free Market Currency Prices

Piasters Per US Dollar



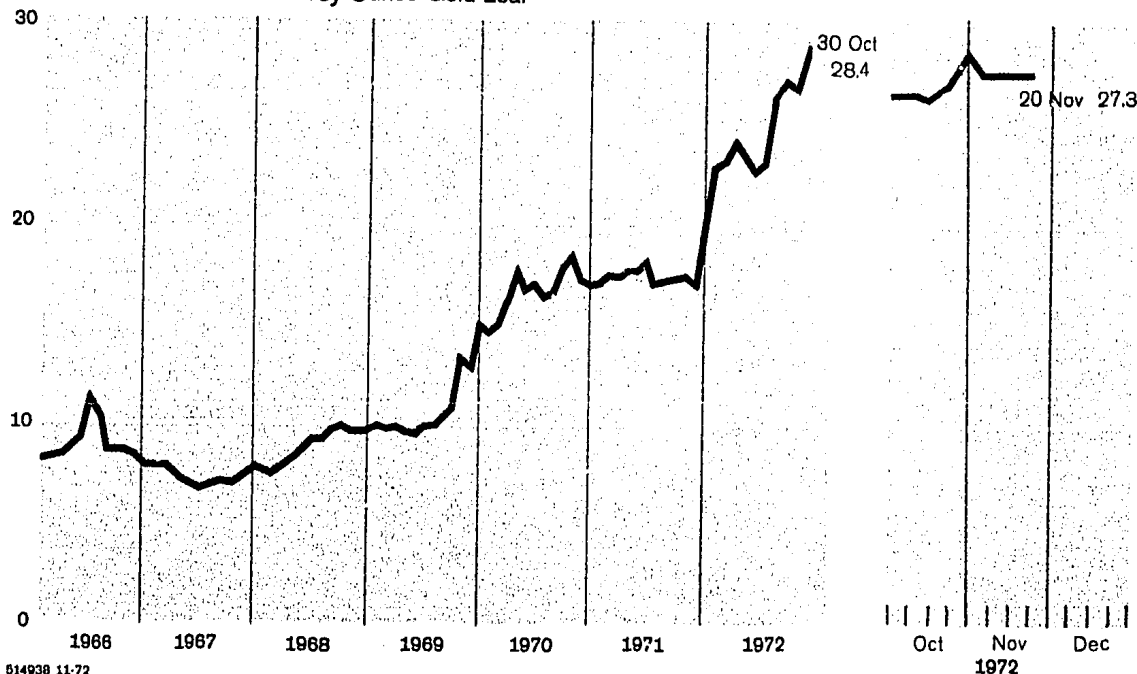
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Figure 4

Free Market Gold Prices

Thousand Piasters Per Troy Ounce Gold Leaf



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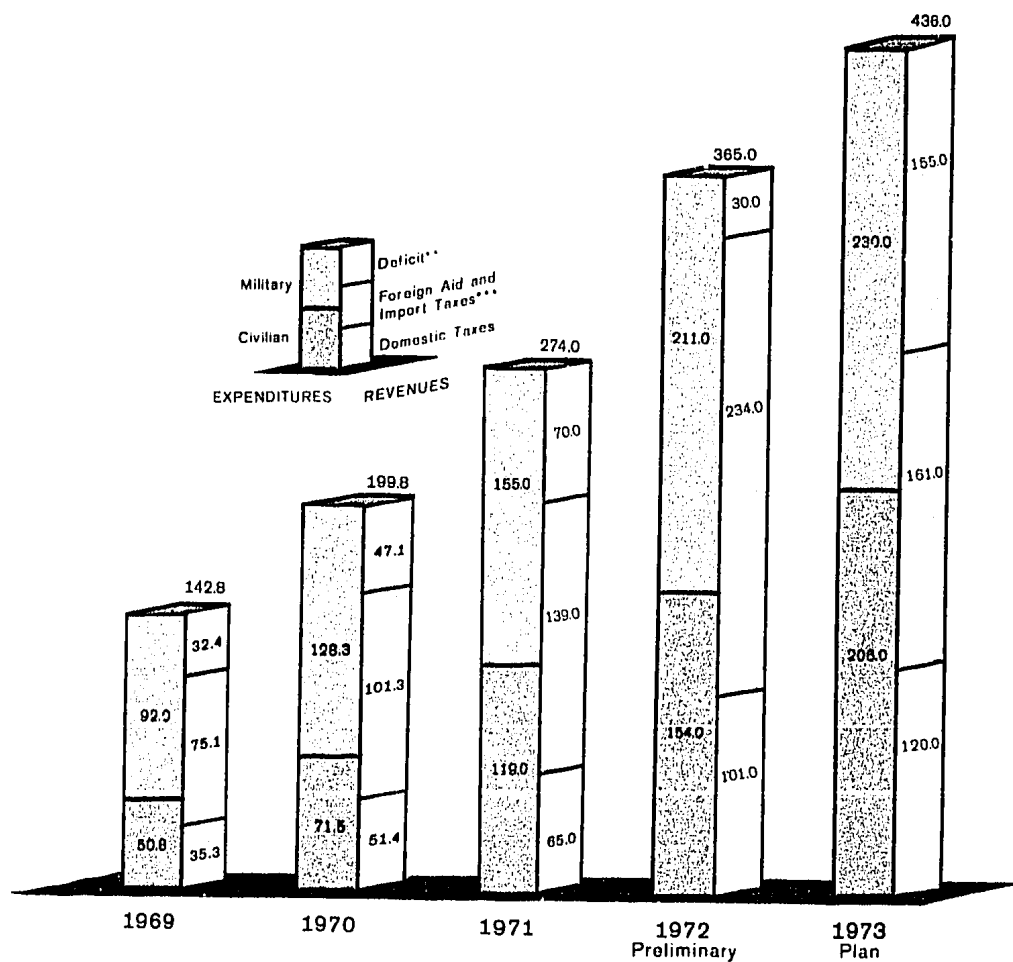
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SOUTH VIETNAM Government Budget*

Billion Piasters

Figure 5



*Data include extrabudgetary revenues and expenditures.

**Residual. Financed primarily by borrowing from the National Bank.

***Includes customs duties and other import taxes, counterpart funds generated by US-financed import programs, and profits from foreign exchange transactions. A major result of the November 1971 reforms was to make explicit a greater share of US aid to the budget that earlier took the form of high customs duties on aid-financed imports.

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